

China Precision Steel, Inc.  
Form 10-Q  
May 15, 2012

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

For the quarterly period ended: March 31, 2012

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-23039

**CHINA PRECISION STEEL, INC.**

(Exact Name of Registrant as Specified in Its Charter)

Delaware **14-1623047**  
(State or other jurisdiction of  
(I.R.S. Employer Identification No.)  
incorporation or organization)

**18th Floor, Teda Building**

**87 Wing Lok Street, Sheungwan, Hong Kong  
People's Republic of China**

(Address of principal executive offices, Zip Code)

**852-2543-2290**

(Registrant's telephone number, including area code)

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(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes " No "

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes " No "

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer "

Accelerated filer "

Non-accelerated filer " (Do not check if a smaller reporting company) Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes " No "

The number of shares outstanding of each of the issuer's classes of common stock, as of May 10, 2012 is as follows:

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| Class of Securities             | Shares Outstanding |
|---------------------------------|--------------------|
| Common Stock, \$0.001 par value | 46,562,955         |

**CHINA PRECISION STEEL, INC.**

***Quarterly Report on Form 10-Q***

***Three and Nine Months Ended March 31, 2012***

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PART I

FINANCIAL INFORMATION

**ITEM 1. FINANCIAL STATEMENTS.**

**CHINA PRECISION STEEL, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTHS ENDED MARCH 31, 2012 AND 2011**

**INDEX TO FINANCIAL STATEMENTS**

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**China Precision Steel, Inc. and Subsidiaries****Consolidated Balance Sheets****(Unaudited)**

|                                                                                                                          | Notes | March 31,<br>2012 | June 30,<br>2011 |
|--------------------------------------------------------------------------------------------------------------------------|-------|-------------------|------------------|
| <b>Assets</b>                                                                                                            |       |                   |                  |
| Current assets                                                                                                           |       |                   |                  |
| Cash and cash equivalents                                                                                                |       | \$2,244,609       | \$2,707,754      |
| Accounts receivable                                                                                                      |       |                   |                  |
| Trade, net of allowances of \$1,091,900 and \$1,063,620 at March 31, 2012 and June 30, 2011, respectively                | 5     | 45,250,344        | 41,335,759       |
| Bills receivable                                                                                                         |       | 182,656           | 201,133          |
| Other receivables                                                                                                        |       | 1,570,111         | 1,420,192        |
| Inventories, net                                                                                                         | 6     | 28,518,286        | 25,077,449       |
| Prepaid expenses                                                                                                         |       | 725,445           | 633,416          |
| Advances to suppliers, net of allowance of \$2,297,554 and \$1,724,275 at March 31, 2012 and June 30, 2011, respectively | 7     | 48,933,681        | 50,034,590       |
| Total current assets                                                                                                     |       | 127,425,132       | 121,410,293      |
| Property, plant and equipment                                                                                            |       |                   |                  |
| Property, plant and equipment, net                                                                                       | 8     | 70,389,316        | 75,311,221       |
| Construction-in-progress                                                                                                 | 9     | 80,191            | 64,762           |
|                                                                                                                          |       | 70,469,507        | 75,375,983       |
| Intangible assets, net                                                                                                   | 10    | 1,908,973         | 1,892,249        |
| Goodwill                                                                                                                 |       | 99,999            | 99,999           |
| Total assets                                                                                                             |       | \$199,903,611     | \$198,778,524    |
| <b>Liabilities and Stockholders' Equity</b>                                                                              |       |                   |                  |
| Current liabilities                                                                                                      |       |                   |                  |
| Short-term loans                                                                                                         | 11    | \$27,502,237      | \$27,370,648     |
| Long-term loan - current portion                                                                                         | 12    | 3,600,000         | 3,600,000        |
| Accounts payable and accrued liabilities                                                                                 |       | 8,543,271         | 5,599,323        |
| Advances from customers                                                                                                  |       | 6,423,836         | 2,275,241        |
| Other taxes payable                                                                                                      |       | 6,320,262         | 6,297,227        |
| Current income taxes payable                                                                                             |       | 5,842,782         | 5,691,456        |

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|                                                                                                                                                                   |    |                |                |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|----|----------------|----------------|
| Total current liabilities                                                                                                                                         |    | 58,232,388     | 50,833,895     |
| Long-term loans                                                                                                                                                   | 12 | 12,600,000     | 14,400,000     |
| Stockholders' equity:                                                                                                                                             |    |                |                |
| Preferred stock: \$0.001 per value, 8,000,000 shares authorized, no shares outstanding at March 31, 2012 and June 30, 2011, respectively                          | 13 | -              | -              |
| Common stock: \$0.001 par value, 62,000,000 shares authorized, 46,562,955 and 46,562,955 issued and outstanding at March 31, 2012 and June 30, 2011, respectively | 13 | 46,563         | 46,563         |
| Additional paid-in capital                                                                                                                                        | 13 | 75,642,383     | 75,642,383     |
| Accumulated other comprehensive income                                                                                                                            |    | 20,278,819     | 16,822,185     |
| Retained earnings                                                                                                                                                 |    | 33,103,458     | 41,033,498     |
| Total stockholders' equity                                                                                                                                        |    | 129,071,223    | 133,544,629    |
| Total liabilities and stockholders' equity                                                                                                                        |    | \$ 199,903,611 | \$ 198,778,524 |

The accompanying notes are an integral part of these consolidated financial statements.

**China Precision Steel, Inc. and Subsidiaries****Consolidated Statements of Operations and Comprehensive Income****For the Three and Nine Months Ended March 31, 2012 and 2011****(Unaudited)**

|                                                 | Notes | Three Months Ended<br>March 31,<br>2012 | Three Months Ended<br>March 31,<br>2011 | Nine Months Ended<br>March 31,<br>2012 | Nine Months Ended<br>March 31,<br>2011 |
|-------------------------------------------------|-------|-----------------------------------------|-----------------------------------------|----------------------------------------|----------------------------------------|
| Sales revenues                                  |       | \$29,494,865                            | \$31,489,118                            | \$105,324,043                          | \$105,154,101                          |
| Cost of goods sold                              |       | 30,612,073                              | 31,530,734                              | 108,178,198                            | 100,902,769                            |
| Gross (loss)/profit                             |       | (1,117,208 )                            | (41,616 )                               | (2,854,155 )                           | 4,251,332                              |
| Operating expenses                              |       |                                         |                                         |                                        |                                        |
| Selling expenses                                |       | 63,734                                  | 93,172                                  | 172,223                                | 201,554                                |
| Administrative expenses                         |       | 781,221                                 | 111,068                                 | 2,007,777                              | 1,708,188                              |
| Allowance for bad and doubtful debts            |       | 522,118                                 | 126                                     | 522,118                                | 19,823                                 |
| Depreciation and amortization expense           |       | 54,173                                  | 50,173                                  | 162,610                                | 143,884                                |
| Total operating expenses                        |       | 1,421,246                               | 254,539                                 | 2,864,728                              | 2,073,449                              |
| (Loss)/income from operations                   |       | (2,538,454 )                            | (296,155 )                              | (5,718,883 )                           | 2,177,883                              |
| Other income/(expense)                          |       |                                         |                                         |                                        |                                        |
| Other revenues                                  |       | 20,434                                  | 627                                     | 89,505                                 | 3,239                                  |
| Interest and finance costs                      |       | (794,895 )                              | (591,118 )                              | (2,273,473 )                           | (1,908,969 )                           |
| Total other (expense)                           |       | (774,461 )                              | (590,491 )                              | (2,183,968 )                           | (1,905,730 )                           |
| (Loss)/income from operations before income tax |       | (3,312,915 )                            | (886,646 )                              | (7,902,851 )                           | 272,153                                |
| Provision for income tax                        | 14    |                                         |                                         |                                        |                                        |
| Current                                         |       | 108                                     | (14,149 )                               | 27,189                                 | 298,358                                |
| Total income tax expense/(benefit)              |       | 108                                     | (14,149 )                               | 27,189                                 | 298,358                                |
| Net (loss)                                      |       | \$(3,313,023 )                          | \$(872,497 )                            | \$(7,930,040 )                         | \$(26,205 )                            |
| Basic (loss) per share                          | 15    | \$(0.07 )                               | \$(0.02 )                               | \$(0.17 )                              | \$(0.00 )                              |
| Basic weighted average shares outstanding       |       | 46,562,955                              | 46,562,955                              | 46,562,955                             | 46,562,955                             |

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|                                             |    |               |               |                 |                |   |
|---------------------------------------------|----|---------------|---------------|-----------------|----------------|---|
| Diluted (loss) per share                    | 15 | \$ (0.07      | ) \$ (0.02    | ) \$ (0.17      | ) \$ (0.00     | ) |
| Diluted weighted average shares outstanding |    | 46,562,955    | 46,562,955    | 46,562,955      | 46,562,955     |   |
| Components of comprehensive (loss)/income:  |    |               |               |                 |                |   |
| Net (loss)                                  |    | \$ (3,313,023 | ) \$ (872,497 | ) \$ (7,930,040 | ) \$ (26,205   | ) |
| Foreign currency translation adjustment     |    | 185,979       | 1,334,946     | 3,456,634       | 4,802,853      |   |
| Comprehensive (loss)/income                 |    | \$ (3,127,044 | ) \$ 462,449  | \$ (4,473,406   | ) \$ 4,776,648 |   |

The accompanying notes are an integral part of these consolidated financial statements.

**China Precision Steel, Inc. and Subsidiaries**

**Consolidated Statements of Changes in Stockholders' Equity**

**For the Nine Months Ended March 31, 2012**

**(Unaudited)**

|                                         | Ordinary Share | Shares Amount | Additional Paid-in Capital | Accumulated Other Comprehensive Income | Retained Earnings | Total Stockholders' Equity |
|-----------------------------------------|----------------|---------------|----------------------------|----------------------------------------|-------------------|----------------------------|
| Balance at June 30, 2011                | 46,562,955     | 46,563        | 75,642,383                 | 16,822,185                             | 41,033,498        | 133,544,629                |
| Foreign currency translation adjustment | -              | -             | -                          | 3,456,634                              | -                 | 3,456,634                  |
| Net loss                                | -              | -             | -                          | -                                      | (7,930,040 )      | (7,930,040 )               |
| Balance at March 31, 2012               | 46,562,955     | \$46,563      | \$75,642,383               | \$ 20,278,819                          | \$33,103,458      | \$129,071,223              |

The accompanying notes are an integral part of these consolidated financial statements.

**China Precision Steel, Inc. and Subsidiaries****Consolidated Statements of Cash Flows****For the Nine Months Ended March 31, 2012 and 2011****(Unaudited)**

|                                                                                  | 2012          | 2011         |
|----------------------------------------------------------------------------------|---------------|--------------|
| Cash flows from operating activities                                             |               |              |
| Net (loss)                                                                       | \$(7,930,040) | \$(26,205 )  |
| Adjustments to reconcile net income to net cash provided by operating activities |               |              |
| Depreciation and amortization                                                    | 6,763,799     | 5,931,643    |
| Gain on disposal of property, plant and equipment                                | (36,945 )     | -            |
| Allowance for bad and doubtful debts                                             | 522,118       | -            |
| Inventory provision                                                              | 636,405       | -            |
| Net changes in assets and liabilities:                                           |               |              |
| Accounts receivable, net                                                         | (3,448,433)   | 18,758,490   |
| Inventories                                                                      | (3,416,954)   | (3,171,550 ) |
| Prepaid expenses                                                                 | (86,378 )     | (236,418 )   |
| Advances to suppliers                                                            | 2,365,370     | (21,066,432) |
| Accounts payable and accrued expenses                                            | 3,343,901     | (4,980,726 ) |
| Advances from customers                                                          | 4,088,100     | 478,006      |
| Other taxes payable                                                              | (144,398 )    | 212,193      |
| Current income taxes                                                             | -             | 138,962      |
| Net cash provided by/(used in) operating activities                              | 2,656,545     | (3,962,037 ) |
| Cash flows from investing activities                                             |               |              |
| Purchase of property, plant and equipment, including construction in progress    | (365,568 )    | (9,635,527 ) |
| Proceeds from disposal of property, plant and equipment                          | 55,933        | -            |
| Net cash (used in) investing activities                                          | (309,635 )    | (9,635,527 ) |
| Cash flows from financing activities                                             |               |              |
| Loan proceeds                                                                    | -             | 497,816      |
| Repayment of short-term loans                                                    | -             | (771,106 )   |
| Repayment of long-term loan                                                      | (2,874,740)   | -            |
| Net cash (used in) financing activities                                          | (2,874,740)   | (273,290 )   |
| Effect of exchange rate                                                          | 64,685        | 1,242,139    |
| Net (decrease) in cash                                                           | (463,145 )    | (12,628,715) |

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|                                                |             |              |
|------------------------------------------------|-------------|--------------|
| Cash and cash equivalents, beginning of period | 2,707,754   | 29,036,706   |
| Cash and cash equivalents, end of period       | \$2,244,609 | \$16,407,991 |

The accompanying notes are an integral part of these consolidated financial statements.

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**China Precision Steel, Inc.**

**Notes to the Consolidated Financial Statements**

**(Unaudited)**

**1. Description of Business**

China Precision Steel, Inc. (the “Company,” “CPSL” or “we”) is a niche and high value-added steel processing company principally engaged in the manufacture and sale of cold-rolled precision steel products for downstream applications including automobile components and spare parts, kitchen tools, electrical appliances, roofing and food packaging materials. Raw materials, hot-rolled steel coils, will go through certain reduction, heating and cutting processing procedures to give steel coils or plates different thickness and specifications for deliveries in accordance with customers’ requirements. Specialty precision steel offers specific control of thickness, shape, width, surface finish and other special quality features that compliment the emerging need for highly engineered end use applications. Precision steel pertains to the precision of measurements and tolerances of the above factors, especially thickness tolerance.

We have five wholly-owned subsidiaries, Partner Success Holdings Limited (“PSHL”), Blessford International Limited (“Blessford International”), Shanghai Chengtong Precision Strip Company Limited (“Chengtong”), Shanghai Blessford Alloy Company Limited (“Shanghai Blessford”) and Shanghai Tuorong Precision Strip Company Limited (“Tuorong”). The Company’s principal activities are conducted through our two operating subsidiaries, Chengtong and Shanghai Blessford with manufacturing facilities located in Shanghai, the People’s Republic of China (the “PRC”). The sole activity of Tuorong is the ownership of land use rights with respect to facilities utilized by Chengtong and Shanghai Blessford. PSHL and Blessford International are both British Virgin Islands companies with the sole purpose of investment holding.

**2. Basis of Preparation of Financial Statements**

The financial statements have been prepared in order to present the consolidated financial position and consolidated results of operations in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) and are expressed in terms of US dollars (see Note 3 “Functional Currency and Translating Financial Statements” below).

The accompanying unaudited consolidated financial statements as of March 31, 2012 and for the periods ended March 31, 2012 and 2011 have been prepared in accordance with US GAAP and with the instructions to Form 10-Q and Regulation S-X applicable to smaller reporting companies. In the opinion of management, these unaudited consolidated financial statements include all adjustments considered necessary to make the financial statements not

misleading. The results of operations for the three and nine months ended March 31, 2012 are not necessarily indicative of the results to be expected for the full year ending June 30, 2012.

### 3. Summary of Significant Accounting Policies

The following is a summary of significant accounting policies:

**Cash and Cash Equivalents** – The Company considers all highly liquid debt instruments purchased with a maturity period of three months or less to be cash equivalents. The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents approximate their fair value.

**Accounts Receivable** – Credit periods vary substantially across industries, segments, types and size of companies in the PRC where we operate our business. Because of the niche products that we process, our customers are usually also niche players in their own respective segment, who then sell their products to end product manufacturers. The business cycle is relatively long, as well as the credit periods. The Company offers credit to its customers for periods of 60 days, 90 days, 120 days and 180 days. We generally offer longer credit terms to long-standing recurring customers with good payment histories and sizable operations. Accounts receivable are recorded at the time revenue is recognized and are stated net of allowance for doubtful accounts.

**Allowance for Doubtful Accounts** – The Company maintains an allowance for doubtful accounts based on its assessment of the collectability of the accounts receivable. Management determines the collectability of outstanding accounts by maintaining regular communication with such customers and obtaining confirmation of their intent to fulfill their obligations to the Company. Management also considers past collection experience, our relationship with customers and the impact of current economic conditions on our industry and market. However, we note that the continuation or intensification of the current global economic crisis may have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations. To allow for potentially uncollectible accounts receivable, management has made a 50% provision for all accounts receivable that are over 180 days past due and a full provision for all accounts receivable which were past due over 1 year. From time to time, we review these credit periods, along with our collection experience and the other factors discussed above, to evaluate the adequacy of our allowance for doubtful accounts, and to make changes to the allowance, if necessary. If our actual collection experience or other conditions change, revisions to our allowances may be required, including a further provision which could adversely affect our operating income, or write back of provision when estimated uncollectible accounts are actually collected. At March 31, 2012 and June 30, 2011, the Company had made allowances for doubtful accounts of \$1,091,900 and \$1,063,620, respectively.

Bad debts are written off for past due balances over two years or when it becomes known to management that such amount is uncollectible. There was a provision for bad debts of \$522,118 recognized for the three and nine months ended March 31, 2012. There was a provision for bad debts of \$126 and \$19,823 recognized for the three and nine months ended March 31, 2011, respectively.

**Inventories** – Inventories are stated at the lower of cost or market to their net realizable values, after providing for cost of anticipated losses, wherever considered necessary. Cost is determined using the weighted average method. Market value represents the estimated selling price in the ordinary course of business less the estimated costs necessary to complete the sale.

Cost of inventories comprises all costs of purchases, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Costs of conversion of inventories include fixed and variable production overheads, taking into account the stage of completion.

There was an inventory provision of \$689,000 recognized for the three and nine months ended March 31, 2012, as compared to an inventory provision of \$44,922 recognized for the three and nine months ended March 31, 2011.

**Intangible Assets and Amortization** – Intangible assets represent land use rights in China acquired by the Company and are stated at cost less amortization and impairment, if any. Amortization of land-use rights is calculated on the straight-line method, based on the period over which the right is granted by the relevant authorities in China.

**Advances to Suppliers** – In order to ensure a steady supply of raw materials, the Company is required from time to time to make cash advances to its suppliers when placing purchase orders, for a guaranteed minimum delivery quantity at future times when raw materials are required. The advance is seen as a deposit to suppliers and guarantees our access to raw materials during periods of shortages and market volatility, and is therefore considered an important component of our operations. Contracted raw materials are priced at prevailing market rates agreed by us with the suppliers prior to each delivery date. Advances to suppliers are shown net of an allowance which represents potentially unrecoverable cash advances at each balance sheet date. Such allowances are based on an analysis of past raw materials receipt experience and the credibility of each supplier according to its size and background. In general, we do not provide allowances against advances paid to those PRC state-owned companies as there is minimal risk of default. Our allowances for advances to suppliers are subjective critical estimates that have a direct impact on reported net earnings, and are reviewed quarterly at a minimum to reflect changes from our historic raw materials receipt experience and to ensure the appropriateness of the allowance in light of the circumstances present at the time of the review. It is reasonably possible that the Company's estimate of the allowance will change, such as in the case when the Company becomes aware of a supplier's inability to deliver the contracted raw materials or meet its financial obligations. As of March 31, 2012 and June 30, 2011, the Company had made allowances of advances to suppliers of \$2,297,554 and \$1,724,275, respectively.

Allowances for advances to suppliers are written off when all efforts to collect the materials or recover the cash advances have been unsuccessful, or when it has become known to the management that there is no intention by the suppliers to deliver the contracted raw materials or refund the cash advances. To date, we have not written off any advances to suppliers.

**Property, Plant and Equipment** – Property, plant and equipment are stated at cost less accumulated depreciation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its present working condition and location for its intended use.

Depreciation is computed on a straight-line basis over the estimated useful lives of the related assets for financial reporting purposes. The estimated useful lives for significant property and equipment are as follows:

|                     |          |
|---------------------|----------|
| Buildings           | 10 years |
| Plant and machinery | 10 years |
| Motor vehicles      | 5 years  |
| Office equipment    | 5 years  |

Repairs and maintenance costs are normally charged to the statement of operations in the year in which they are incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalized as an additional cost of the asset.

**Impairment of Long-Lived Assets** – The Company accounts for impairment of property, plant and equipment and amortizable intangible assets in accordance with ASC Topic No. 360 “Property, Plant and Equipment” (“ASC 360”), which requires the Company to evaluate a long-lived asset for recoverability when there is an event or circumstance that indicates the carrying value of the asset may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset or asset group is not recoverable (when carrying amount exceeds the gross, undiscounted cash flows from use and disposition) and is measured as the excess of the carrying amount over the asset’s (or asset group’s) fair value.

**Capitalized Interest** – The Company capitalizes interest cost on borrowings incurred during the new construction or upgrade of qualified assets. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful lives of the assets. During the nine months ended March 31, 2012 and 2011, the Company capitalized \$nil interest to construction-in-progress.

**Construction-in-Progress** – Plant and production lines currently under development are accounted for as construction-in-progress. Construction-in-progress is recorded at acquisition cost, including land rights cost,

development expenditure, professional fees and the interest expenses capitalized during the course of construction for the purpose of financing the project. Upon completion and readiness for use of the project, the cost of construction-in-progress is to be transferred to property, plant and equipment.

**Contingent Liabilities and Contingent Assets** – A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company. It can also be a present obligation arising from past events that is not recognized because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognized but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, the contingency is then recognized as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Company.

Contingent assets are not recognized but are disclosed in the notes to the financial statements when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognized.

**Advances from Customers** – Advances from customers represent advance cash receipts from customers and for which goods have not been delivered or services have not been rendered at each balance sheet date. Advances from customers for goods to be delivered or services to be rendered in the subsequent period are carried forward as deferred revenue.

**Revenue Recognition** – Revenue from the sale of goods and services is recognized on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and the title has passed and services have been rendered. Revenue is reported net of all VAT taxes. Other income is recognized when it is earned.

**Functional Currency and Translating Financial Statements** – The Company’s principal country of operations is the PRC. Our functional currency is Chinese Renminbi; however, the accompanying consolidated financial statements have been expressed in United States Dollars (“USD”). The consolidated balance sheets have been translated into USD at the exchange rates prevailing at each balance sheet date. The consolidated statements of operations and cash flows have been translated using the weighted-average exchange rates prevailing during the periods of each statement. The registered equity capital denominated in the functional currency is translated at the historical rate of exchange at the time of capital contribution. All translation adjustments resulting from the translation of the financial statements into the reporting currency are dealt with as other comprehensive income in stockholders’ equity.

**Accumulated Other Comprehensive Income** – Accumulated other comprehensive income represents the change in equity of the Company during the periods presented from foreign currency translation adjustments.

**Taxation** – Taxation on profits has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the country in which the Company operates.

#### United States

China Precision Steel, Inc. is subject to United States federal income tax at a tax rate of 34%. No provision for income taxes in the United States has been made as China Precision Steel, Inc. had no taxable income in the 2012 and 2011 periods.

BVI

PSHL and Blessford International were incorporated in the British Virgin Islands and, under the current laws of the British Virgin Islands, are not subject to income taxes.

PRC

Provision for the PRC enterprise income tax is calculated at the prevailing rate based on the estimated assessable profits less available tax relief for losses brought forward. The Company does not accrue taxes on unremitted earnings from foreign operations as it is the Company's intention to invest these earnings in the foreign operations indefinitely.

*Enterprise income tax*

On March 16, 2007, the National People's Congress of China passed The Enterprise Income Tax Law (the "New EIT Law"), and on December 6, 2007, the State Council of China passed the Implementing Rules for the EIT Law ("Implementing Rules") which took effect on January 1, 2008. The New EIT Law and Implementing Rules impose a unified enterprise income tax ("EIT") of 25% on all domestic-invested enterprises and foreign-invested entities ("FIEs"), unless they qualify under certain limited exceptions. Therefore, nearly all FIEs are subject to the new tax rate alongside other domestic businesses rather than benefiting from the old FIE tax laws, and its associated preferential tax treatments, beginning January 1, 2008.

Despite these changes, the EIT Law gives the FIEs established before March 16, 2007 (“Old FIEs”) a five-year grandfather period during which they can continue to enjoy their existing preferential tax treatments, commonly referred to as “tax holidays”, until these holidays expire. As an Old FIE, Chengtong’s tax holiday of a 50% reduction in the 25% statutory rates expired on December 31, 2008 and it is currently subject to the 25% statutory rates since January 1, 2009; Shanghai Blessford’s full tax exemption from the enterprise income tax expired on December 31, 2009, and it is subject to a 50% reduction for the three subsequent years expiring on December 31, 2012. Subsequent to the expiry of their tax holidays, Chengtong and Shanghai Blessford will be subject to enterprise income taxes at 25% or the prevailing statutory rates. The discontinuation of any such special or preferential tax treatment or other incentives would have an adverse effect on any organization’s business, fiscal condition and current operations in China.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carry forwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Company follows the provisions of the ASC Topic No. 740 “Accounting for Income Taxes” and “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109” (“ASC 740”). ASC 740 requires the recognition of tax benefits or expenses based on the estimated future tax effects of temporary differences between the financial statements and tax bases of its assets and liabilities. Deferred tax assets and liabilities primarily relate to tax basis differences on unrealized gains on corporate equities, stock-based compensation, amortization periods of certain intangible assets and differences between the financial statements and tax bases of assets acquired.

The Company recognizes that virtually all tax positions in the PRC are not free of some degree of uncertainty due to tax law and policy changes in the PRC. However, the Company cannot reasonably quantify political risk factors and thus must depend on guidance issued by current officials in the PRC.

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax benefits as of March 31, 2012 is not material to its results of operations, financial condition or cash flows. The Company also believes that the total amount of unrecognized tax benefits as of March 31, 2012, if recognized, would not have a material effect on its effective tax rate. The Company further believes that there are no tax positions for which it is reasonably possible, based on current Chinese tax law and policy, that the unrecognized tax benefits will significantly increase or decrease over the next 12 months producing, individually or in the aggregate, a material effect on the Company’s results of operations, financial condition or cash flows.

*Value added tax*

The Provisional Regulations of the People's Republic of China Concerning Value Added Tax promulgated by the State Council came into effect on January 1, 1994. Under these regulations and the Implementing Rules of the Provisional Regulations of the People's Republic of China Concerning Value Added Tax, value added tax is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC.

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Value added tax payable in the PRC is charged on an aggregated basis at a rate of 13% or 17% (depending on the type of goods involved) on the full price collected for the goods sold or, in the case of taxable services provided, at a rate of 17% on the charges for the taxable services provided, but excluding, in respect of both goods and services, any amount paid in respect of value added tax included in the price or charges, and less any deductible value added tax already paid by the taxpayer on purchases of goods and services in the same financial year.

The revised People's Republic of China Tentative Regulations on Value Added Tax became effective on January 1, 2009 with the issuance of Order of the State Council No. 538. With the implementation of this VAT reform, input VAT associated with the purchase of fixed assets is now deductible against output VAT.

**Retirement Benefit Costs** – According to the PRC regulations on pension, Chengtong and Shanghai Blessford contribute to a defined contribution retirement scheme organized by municipal government in the province in which Chengtong and Shanghai Blessford were registered and all qualified employees are eligible to participate in the scheme. Contributions to the scheme are calculated at 37% of the employees' salaries above a fixed threshold amount and the employees contribute 11%. The Group has no other material obligation for the payment of retirement benefits beyond the annual contributions under this scheme.

For the nine months ended March 31, 2012 and 2011, the Company's pension cost charged to the statements of operations under the plan amounted to \$199,975 and \$156,227, respectively, all of which have been paid to the National Social Security Fund.

**Fair Value of Financial Instruments** – The carrying amounts of certain financial instruments, including cash, accounts receivable, other receivables, short-term loans, accounts payable, accrued expenses, and other payables approximate their fair values as at March 31, 2012 and June 30, 2011 because of the relatively short-term maturity of these instruments. The Company considers the carrying amount of long-term loans to approximate their fair values based on the interest rates of the instruments and the current market rate of interest.

**Use of Estimates** – The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### **4. Concentrations of Business and Credit Risk**

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The Company's list of customers whose purchases from us were 10% or more of total sales during nine months ended March 31, 2012 and 2011 is as follows:

|                                                 | 2012       |            | 2011       |            |
|-------------------------------------------------|------------|------------|------------|------------|
| a. Customers                                    | \$         | % to sales | \$         | % to sales |
| Shanghai Shengdejia Metal Products Co., Ltd.    | 14,107,630 | 13         | 23,169,045 | 22         |
| Shanghai Changshuo Steel Co., Ltd.              | 12,068,785 | 11         | 16,927,848 | 16         |
| Hangzhou Cogeneration Import & Export Co., Ltd. | 11,204,723 | 11         | -          | * - *      |

*\* Not 10% customers for the relevant periods*

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The Company's list of suppliers whose sales to us were 10% or more of total purchases during nine months ended March 31, 2012 and 2011 is as follows:

| b. Suppliers                                    | 2012       |                | 2011         |                |
|-------------------------------------------------|------------|----------------|--------------|----------------|
|                                                 | \$         | % to purchases | \$           | % to purchases |
| Hebei Nuojin Steel Co., Ltd.                    | 22,800,704 | 24             | -            | * - *          |
| Dachang Huizu Baosheng Steel Products Co., Ltd. | 21,403,015 | 23             | 23,306,122   | 27             |
| Wuxi Hangda Trading Co., Ltd.                   | 13,530,357 | 14             | 14,493,971   | 16             |
| Shanghai Piyun Steel Co., Ltd.                  | 11,142,163 | 12             | -            | * - *          |
| Zhejiang Wuchan Metal Group Co., Ltd.           | -          | *              | * 14,875,802 | 17             |

*\* Not 10% suppliers for the relevant periods*

Our management continues to take appropriate actions to perform ongoing business and credit reviews of our customers to reduce our exposure to new and recurring customers who have been deemed to pose a high credit risk to our business based on their commercial credit reports, our collection history, and our perception of the risk posed by their geographic location.

## 5. Accounts Receivable

The Company provides credit in the normal course of business. The Company performs ongoing credit evaluations of its domestic and international customers and clients and maintains allowances for bad and doubtful accounts based on factors surrounding the credit risk of specific customers and clients, historical trends, and other information. Trade accounts receivable, net totaled \$45,250,344 and \$41,335,759 as of March 31, 2012 and June 30, 2011, respectively.

From time to time, accounts receivable are reviewed for changes from the historic collection experience to ensure the appropriateness of the allowances. These estimates have been relatively accurate in the past and currently there is no need to revise such estimates. However, we will review such estimates more frequently when needed, and make revisions if necessary. The continuation or intensification of the current global economic crisis and turmoil in the global financial markets may have negative consequences for the business operations of our customers and adversely impact their ability to meet their obligations to us. A significant change in our collection experience, deterioration in the aging of receivables and collection difficulties could require that we increase our estimate of the allowance for doubtful accounts. Any such additional bad debt charges could materially and adversely affect our future operating results.

**6. Inventories**

The Company was required under GAAP to write down the value of its inventories to their net realizable values (average selling prices less reasonable costs to convert the inventories into completed form) in the amounts of \$689,000 and \$44,922 as of March 31, 2012 and June 30, 2011, respectively.

As of March 31, 2012 and June 30, 2011, inventories consisted of the following:

|                  | March 31,<br>2012 | June 30,<br>2011 |
|------------------|-------------------|------------------|
| At cost:         |                   |                  |
| Raw materials    | \$5,742,597       | \$5,360,128      |
| Work in progress | 7,771,676         | 7,097,117        |
| Finished goods   | 10,863,000        | 8,744,037        |
| Consumable items | 4,830,013         | 3,921,089        |
|                  | 29,207,286        | 25,122,371       |
| Less: provision  | (689,000 )        | (44,922 )        |
|                  | \$28,518,286      | \$25,077,449     |

Costs of finished goods include direct labor, direct materials, and production overhead before the goods are ready for sale.

Consumable items represent parts used in our cold rolling mills and other equipment that need to be replaced from time to time when necessary to ensure optimal operating results, such as bearings and rollers.

Inventories amounting to \$8,338,547 (June 30, 2011: \$7,096,698) were pledged for short-term loans totaling \$19,536,214 (June 30, 2011: \$19,030,232) at March 31, 2012.

## 7. Advances to Suppliers

Cash advances are shown net of allowances of \$2,297,554 and \$1,724,275 at March 31, 2012 and June 30, 2011, respectively.

Some of our suppliers are state-owned companies in the PRC or their subsidiaries. We believe that advances paid to state-owned companies are ultimately collectible because they are backed by the full faith and credit of the PRC government. As such, we generally do not provide allowances against such advances.

## 8. Property, Plant and Equipment

Property, plant and equipment, stated at cost less accumulated depreciation, consisted of the following:

|                                | March 31,<br>2012 | June 30,<br>2011 |
|--------------------------------|-------------------|------------------|
| Plant and machinery            | \$77,511,619      | \$75,670,080     |
| Buildings                      | 23,658,155        | 23,045,416       |
| Motor vehicles                 | 657,711           | 699,229          |
| Office equipment               | 541,020           | 519,421          |
|                                | 102,368,505       | 99,934,146       |
| Less: Accumulated depreciation | (31,979,189 )     | (24,622,925 )    |
|                                | \$70,389,316      | \$75,311,221     |

Depreciation expense related to manufacturing is included as a component of cost of goods sold. During the nine months ended March 31, 2012 and 2011, depreciation totaling \$4,543,995 and \$3,859,270, respectively, was included as a component of cost of goods sold.

Plant and machinery amounting to \$35,797,128 (June 30, 2011: \$38,109,339) and \$20,353,760 (June 30, 2011: \$21,744,337) were pledged for short-term loans totaling \$27,502,237 and long-term loans including current portion totaling \$16,200,000, respectively, at March 31, 2012 (June 30, 2011: \$27,189,629 and \$18,000,000, respectively).

## **9. Construction-In-Progress**

As of March 31, 2012 and June 30, 2011, construction-in-progress consisted of the following:

|                    | March 31,<br>2012 | June 30,<br>2011 |
|--------------------|-------------------|------------------|
| Construction costs | \$ 80,191         | \$ 64,762        |

Construction-in-progress represents construction and installations of annealing furnaces.

## **10. Intangible Assets**

Land use rights amounting to \$1,905,460 (June 30, 2011: \$1,886,717) were pledged for short-term loans totaling \$27,502,237 at March 31, 2012 (June 30, 2011: \$27,189,629).

The Company acquired land use rights in August 2004 and December 2006 for 50 years that expire in August 2054 and December 2056, respectively. The land use rights are amortized over a fifty-year term. An amortization amount of approximately \$37,000 is to be recorded each year starting from the financial year ended June 30, 2009 for the remaining lease period.

Amortizable intangible assets of the Company are reviewed when there are triggering events to determine whether their carrying value has become impaired, in conformity with ASC 360. The Company also re-evaluates the periods of amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives.

## 11. Short-Term Loans

Short-term loans consisted of the following:

|                                                                                                                                                                                                              | March 31,<br>2012 | June 30,<br>2011 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|------------------|
| Bank loan dated June 29, 2011, due July 31, 2012, with an interest rate at 115% of the standard market rate set by the People's Bank of China ("PBOC") (7.544% at March 31, 2012) per annum (Notes 8 and 10) | 7,966,023         | 8,159,397        |
| Bank loan dated June 29, 2011, due July 31, 2012 with an interest rate at 115% of the standard market rate set by PBOC (7.544% at March 31, 2012) per annum (Notes 6, 8 and 10)                              | 19,536,214        | 19,030,232       |
| Bank loan dated January 19, 2011, due July 18, 2011 with an interest rate of 6.42% per annum                                                                                                                 | -                 | 181,019          |
|                                                                                                                                                                                                              | \$27,502,237      | \$27,370,648     |

The above bank loans outstanding at March 31, 2012 are Renminbi ("RMB") loans. Other than the bank loan dated January 19, 2011 that was secured by bills receivable, all other short-term loans carry an interest rate of 1.15 times of the standard market rate set by the PBOC, and are secured by inventories, land use rights, buildings and plant and machinery, and guaranteed by PSHL and our former Chairman, Mr. Wo Hing Li. In addition, pursuant to a bank loan agreement entered into between the Company and Raiffeisen Zentralbank Österreich AG ("RZB"), Mr. Li undertakes to maintain a shareholding percentage in the Company of not less than 33.4% unless otherwise agreed to with RZB.

The weighted-average interest rate on short-term loans at March 31, 2012 and June 30, 2011 was 7.54% and 7.25%, respectively.

**12. Long-Term Loan**

|                                                                                                                                                                               | March 31,<br>2012 | June 30,<br>2011 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|------------------|
| Bank loan dated June 29, 2010, due June 15, 2016 with an interest rate of the London Interbank Offered Rate ("LIBOR") plus 4.5% (5.233% at March 31, 2012) per annum (Note 8) | \$ 16,200,000     | \$ 18,000,000    |

On January 29, 2010, Shanghai Blessford entered into a Senior Loan Agreement with DEG -Deutsche Investitions-Und Entwicklungsgesellschaft Mbh ("DEG") for a loan amount up to \$18,000,000 at an annual interest rate of 4.5% above the six-month USD LIBOR rate. The loan is to be repaid semi-annually over five years starting on December 15, 2011 and is secured by a mortgage on the new cold rolling line and annealing furnaces at Shanghai Blessford's facilities and guaranteed by the Company.

Maturities of long-term loan, including current portion, for the years ending June 30:

|       |              |
|-------|--------------|
| 2012  | \$1,800,000  |
| 2013  | \$3,600,000  |
| 2014  | \$3,600,000  |
| 2015  | \$3,600,000  |
| 2016  | \$3,600,000  |
|       | \$14,400,000 |
| Total | \$16,200,000 |

### 13. Stock Warrants

On November 6, 2007, in connection with the Subscription Agreement, the Company issued to certain institutional accredited investors warrants to purchase 1,420,000 shares of Common Stock valued at \$5,374,748, and Roth Capital Partners, LLC, as placement agent, received warrants to purchase 225,600 shares of Common Stock valued at \$887,504. These amounts were recorded as syndication fees offsetting additional paid-in capital. Warrants issued to Roth Capital were not exercised and expired on November 5, 2010.

Information with respect to stock warrants outstanding is as follows:

| Exercise Price | Outstanding June 30, 2011 | Granted | Expired or Exercised | Outstanding March 31, 2012 | Expiration Date |
|----------------|---------------------------|---------|----------------------|----------------------------|-----------------|
| \$ 8.45        | 1,420,000                 | -0-     | -0-                  | 1,420,000                  | May 5, 2013     |

### 14. Income Taxes

For PRC enterprise income tax reporting purposes, the Company is required to compute a 10% salvage value when computing depreciation expense and add back the allowance for doubtful debts. For financial reporting purposes, the Company does not take into account a 10% salvage value when computing depreciation expenses.

The tax holiday resulted in tax savings as follows:

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|                   | Nine months ended |            |
|-------------------|-------------------|------------|
|                   | March 31,         |            |
|                   | 2012              | 2011       |
| Tax savings       | \$ -              | \$ 121,692 |
| Benefit per share |                   |            |
| Basic             | \$ 0.00           | \$ 0.00    |
| Diluted           | \$ 0.00           | \$ 0.00    |

Significant components of the Group's deferred tax assets and liabilities as of March 31, 2012 and June 30, 2011 are as follows:

|                                                 | March 31,<br>2012 | June 30,<br>2011 |
|-------------------------------------------------|-------------------|------------------|
| Deferred tax assets and liabilities:            |                   |                  |
| Net operating loss carried forward              | \$4,374,854       | \$2,356,664      |
| Temporary differences resulting from allowances | 1,008,029         | 2,013,737        |
| Net deferred income tax asset                   | 5,382,883         | 4,370,401        |
| Valuation allowance                             | (5,382,883)       | (4,370,401)      |
|                                                 | \$-               | \$-              |

The Company has not recognized a deferred tax liability in respect of the undistributed earnings of its foreign subsidiaries of approximately \$11,473,778 as of March 31, 2012 because the Company currently plans to reinvest those unremitted earnings such that the remittance of the undistributed earnings of those foreign subsidiaries to the Company will be postponed indefinitely. A deferred tax liability will be recognized when the Company no longer plans to permanently reinvest undistributed earnings.

A reconciliation of the provision for income taxes with amounts determined by the PRC income tax rate to income tax expense per books is as follows:

|                                                                 | Nine months ended<br>March 31, |            |
|-----------------------------------------------------------------|--------------------------------|------------|
|                                                                 | 2012                           | 2011       |
| Computed tax of pre-tax (loss) at the PRC statutory rate of 25% | \$(2,018,204)                  | \$(2,138 ) |
| Valuation allowance                                             | 2,018,190                      | 351,210    |
| Income not subject to tax                                       | -                              | (81,188 )  |
| Expenses not deductible for tax                                 | 14                             | -          |
| Underprovision in prior year                                    | 27,189                         | 152,166    |
| Benefit of tax holiday                                          | -                              | (121,692)  |
| Income tax expense per books                                    | \$27,189                       | 298,358    |

Income tax expense consists of:

|                                         | Nine months ended<br>March 31, |           |
|-----------------------------------------|--------------------------------|-----------|
|                                         | 2012                           | 2011      |
| Income tax expense for the period – PRC | \$27,189                       | \$298,358 |
| Deferred income tax benefit – PRC       | -                              | -         |
| Income tax expense per books            | \$27,189                       | \$298,358 |

## 15. (Loss)/Earnings Per Share

ASC 260-10 requires a reconciliation of the numerator and denominator of the basic and diluted (loss)/earnings per share (EPS) computations.

For the three and nine months ended March 31, 2012, warrants to purchase 1,420,000 shares at an exercise price of \$8.45 were not included as their effect would have been anti-dilutive, however, securities represented by the 1,420,000 warrants still outstanding could potentially dilute basic earnings per share in the future.

For the three and nine months ended March 31, 2011, warrants to purchase 358,392 shares of common stock at an exercise price of \$3.00, 1,420,000 shares at an exercise price of \$8.45 and 225,600 shares at an exercise price of \$7.38 were not included as their effect would have been anti-dilutive.

The following reconciles the components of the EPS computation:

|                                                   | Income<br>(Numerator) | Shares<br>(Denominator) | Per<br>Share<br>Amount |
|---------------------------------------------------|-----------------------|-------------------------|------------------------|
| For the three months ended March 31, 2012:        |                       |                         |                        |
| Net loss                                          | \$(3,313,023 )        |                         |                        |
| Basic EPS loss available to common shareholders   | \$(3,313,023 )        | 46,562,955              | \$ (0.07 )             |
| Effect of dilutive securities:                    |                       |                         |                        |
| Warrants                                          |                       | -                       |                        |
| Diluted EPS loss available to common shareholders | \$(3,313,023 )        | 46,562,955              | \$ (0.07 )             |
| For the three months ended March 31, 2011:        |                       |                         |                        |
| Net loss                                          | \$(872,497 )          |                         |                        |
| Basic EPS loss available to common shareholders   | \$(872,497 )          | 46,562,955              | \$ (0.02 )             |
| Effect of dilutive securities:                    |                       |                         |                        |
| Warrants                                          |                       | -                       |                        |
| Diluted EPS loss available to common shareholders | \$(872,497 )          | 46,562,955              | \$ (0.02 )             |

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|                                                   | Income<br>(Numerator) | Shares<br>(Denominator) | Per<br>Share<br>Amount |
|---------------------------------------------------|-----------------------|-------------------------|------------------------|
| For the nine months ended March 31, 2012:         |                       |                         |                        |
| Net loss                                          | \$ (7,930,040 )       |                         |                        |
| Basic EPS loss available to common shareholders   | \$ (7,930,040 )       | 46,562,955              | \$ (0.17 )             |
| Effect of dilutive securities:                    |                       |                         |                        |
| Warrants                                          |                       | -                       |                        |
| Diluted EPS loss available to common shareholders | \$ (7,930,040 )       | 46,562,955              | \$ (0.17 )             |
| For the nine months ended March 31, 2011:         |                       |                         |                        |
| Net loss                                          | \$ (26,205 )          |                         |                        |
| Basic EPS loss available to common shareholders   | \$ (26,205 )          | 46,562,955              | \$ (0.00 )             |
| Effect of dilutive securities:                    |                       |                         |                        |
| Warrants                                          |                       | -                       |                        |
| Diluted EPS loss available to common shareholders | \$ (26,205 )          | 46,562,955              | \$ (0.00 )             |

## 16. Contingencies and Commitments

### *Legal Proceedings*

The Company is subject to various legal proceedings and claims that have arisen in the ordinary course of business.

On March 15, 2012, the Company received notice of a complaint filed by Mr. Haining Zhang and China Venture Partners, Inc. in the U.S. Southern District Court of New York on March 9, 2012, against several defendants, including the Company, as successor to OraLabs Holding Corp. In the complaint Mr. Zhang is alleging, among other things, breach of contract by the Company and certain of our former officers, directors and control persons, in connection with our December 2006 acquisition of Partner Success Holdings Limited. Among other things, Mr. Zhang alleges that the defendants breached an agreement to compensate him for services he allegedly performed in connection with seeking out a merger candidate for the Company. The Company believes that the suit is without merit and intends to vigorously defend its interests in the case. The Company intends to and has been granted Court permission to file a motion to dismiss the action as against it.

Although an estimate of any potential loss cannot be made at this time, the Company does not believe that its business or financial condition is materially adversely affected.

### *Capital Commitments*

As of March 31, 2012, the Company did not have any capital commitments (June 30, 2011: \$nil).

## **17. Impairment**

We determine impairment of long-lived assets, including property, plant and equipment and amortizable intangible assets, by measuring the estimated undiscounted future cash flows generated by these assets, comparing the result to the assets' carrying values and, if necessary, adjusting the assets to fair value and charging current operations for the measured impairment. The determination of the undiscounted future cash flows and fair value of these assets are subject to significant judgment.

As of March 31, 2012, as the Company's market capitalization was lower than the carrying value of its assets, management performed an impairment test in accordance with ASC360 and no impairment charges were recognized for the relevant period. As of March 31, 2012, the Company expects these assets to be fully recoverable based on the result of the impairment test. Goodwill amounting to \$99,999 as at March 31, 2012 was considered immaterial and not tested for impairment in accordance with ASC 350.

## **18. Recent Accounting Pronouncements**

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" ("ASU 2011-04"). This update amends ASC Topic 820, "Fair Value Measurement and Disclosure." ASU 2011-04 clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. ASU 2011-04 is effective for annual and interim reporting periods beginning on or after December 15, 2011, which means that it became effective for our fiscal quarter beginning January 1, 2012. The new guidance is to be adopted prospectively and early adoption is not permitted. The adoption of ASU 2011-04 did not have a significant impact on our financial position, results of operations or cash flows.

On June 16, 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income" ("ASU 2011-05"). This update amends ASC Topic 220, "Comprehensive Income" to provide that total comprehensive income will be reported in one continuous statement or two separate but consecutive statements of financial performance. Presentation of total comprehensive income in the statement of stockholders' equity or the footnotes will no longer be allowed. The calculation of net income and basic and diluted net income per share will not be affected. ASU 2011-005 is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2011, which means that it will be effective for our fiscal year beginning July 1, 2012. Retrospective adoption is required and early adoption is permitted. We do not believe that adoption of ASU 2011-05 will have a significant impact on our financial position, results of operations or cash flows.

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In September 2011, the FASB issued ASU 2011-08, “Intangibles – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment” (“ASU 2011-08”). ASU No. 2011-08 amends existing guidance by permitting an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. ASU 2011-08 will be effective for interim and annual periods beginning on or after December 15, 2011 with early adoption permitted. We adopted ASU 2011-08 in the current quarter and this did not have a material impact on our financial statements.

## **ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

### **Special Note Regarding Forward Looking Statements**

In addition to historical information, this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We use words such as “believe,” “expect,” “anticipate,” “project,” “target,” “plan,” “optimistic,” “intend,” “aim,” “will” or similar expressions which are intended to identify forward-looking statements. Such statements include, among others, those concerning market and industry segment growth and demand and acceptance of new and existing products; any projections of sales, earnings, revenue, margins or other financial items; any statements of the plans, strategies and objectives of management for future operations; and any statements regarding future economic conditions or performance, as well as all assumptions, expectations, predictions, intentions or beliefs about future events. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, as well as assumptions, which, if they were to ever materialize or prove incorrect, could cause the results of the Company to differ materially from those expressed or implied by such forward-looking statements. Potential risks and uncertainties include, among other things, factors such as: plans to expand our exports outside of China; plans to increase our production capacity and the anticipated dates that such facilities may commence operations; our ability to obtain additional funding for our continuing operations and to fund our expansion; our ability to meet our financial projections for any financial year; our ability to retain our key executives and to hire additional senior management; continued growth of the Chinese economy and industries demanding our products; our ability to secure at acceptable prices the raw materials we need to produce our products; political changes in China that may impact our ability to produce and sell our products in our target markets; general business conditions and competitive factors, including pricing pressures and product development; and changes in our relationships with customers and suppliers. You should carefully review the risk factors described in other documents we file from time to time with the U.S. Securities and Exchange Commission, including our Annual Report on Form 10-K for our fiscal year ended June 30, 2011.

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The following discussion should be read in conjunction with our unaudited consolidated financial statements and the related notes that appear in Part I, Item 1, “Financial Statements,” of this quarterly report. Our unaudited consolidated financial statements are stated in United States Dollars and are prepared in accordance with United States Generally Accepted Accounting Principles. The following discussion and analysis covers the Company’s unaudited consolidated financial condition at March 31, 2012 and June 30, 2011, the end of its prior fiscal year, and its unaudited consolidated results of operation for the three and nine months ended March 31, 2012 and 2011.

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## Use of Terms

Except as otherwise indicated by the context, all references in this report to:

- “CPSL,” “Company,” “Group,” “we,” “us” or “our” are to China Precision Steel, Inc., a Delaware corporation, and its direct and indirect subsidiaries;
- “PSHL” are to our subsidiary Partner Success Holdings Limited, a BVI company;
- “Blessford International” are to our subsidiary Blessford International Limited, a BVI company;
- “Shanghai Blessford” are to our subsidiary Shanghai Blessford Alloy Company Limited, a PRC company;
- “Chengtong” are to our subsidiary Shanghai Chengtong Precision Strip Company Limited, a PRC company;
- “Tuorong” are to our subsidiary Shanghai Tuorong Precision Strip Company Limited, a PRC company;
- “China” and “PRC” are to the People’s Republic of China;
- “BVI” are to the British Virgin Islands;
- “SEC” are to the United States Securities and Exchange Commission;
- “Securities Act” are to the Securities Act of 1933, as amended;
- “Exchange Act” are to the Securities Exchange Act of 1934, as amended;
- “RMB” are to Renminbi, the legal currency of China; and
- “U.S. dollar,” “USD,” “US\$” and “\$” are to the legal currency of the United States.

## Overview of our Business

We are a niche and value-added steel processing company principally engaged in the manufacture and sale of high precision cold-rolled steel products, in the provision of heat treatment and in the cutting and slitting of medium and high-carbon hot-rolled steel strips. We use commodity steel to create a value-added specialty premium steel. Specialty precision steel pertains to the precision of measurements and tolerances of thickness, shape, width, surface finish and other special quality features of highly-engineered end-use applications.

We produce and sell precision ultra-thin and high strength cold-rolled steel products ranging from 7.5 mm to 0.03 mm. We also provide heat treatment and cutting and slitting of medium and high-carbon hot-rolled steel strips not exceeding 7.5 mm thickness. Our process puts hot-rolled de-scaled (pickled) steel coils through a cold-rolling mill, utilizing our patented systems and high technology reduction processing procedures, to make steel coils and sheets in customized thicknesses according to customer specifications. Currently, our specialty precision products are mainly used in the manufacture of automobile parts and components, steel roofing, plane friction discs, appliances, food packaging materials, saw blades, textile needles, and microelectronics.

We conduct our operations principally in China through our wholly-owned operating subsidiaries, Chengtong and Shanghai Blessford, which are wholly owned subsidiaries of our direct subsidiary, PSHL. Most of our sales are made domestically in China; however, we began exporting during fiscal 2007 and our overseas market currently covers Indonesia, Thailand, the Caribbean, Nigeria and Ethiopia. We intend to further expand into additional overseas markets in the future, subject to suitable market conditions and favorable regulatory controls.

### **Third Quarter Financial Performance Highlights**

During the quarter ended March 31, 2012, we saw slightly improving demand but lower selling prices compared to the same period a year ago. There were significant decreases in sales volume for our high carbon products over the three months ended March 31, 2012 and we are faced with multiple challenges including high inflation, high raw material costs and the slowdown of the Chinese economy.

During the quarter ended March 31, 2012, we sold a total of 38,898 tons of products, an increase of 2,423 tons from 36,475 tons a year ago, mainly due to an increase in demand for our low carbon cold-rolled products. However, our low-carbon products have a lower margin among our product categories and gross margin for the quarter ended March 31, 2012 was negative as average cost per unit sold decreased only 8.9% while average selling prices decreased 12.2%, period-on-period. We were not able to fully pass on our cost to our customers due to an increased level of competition in the domestic market for some of our product categories and the strengthening of the RMB over the recent years that has made the price of our products less competitive in the global market. Increased concentration in sales of low-carbon products coupled with decreasing selling prices have led to a gross loss of \$1,117,208 and a net loss of \$3,313,023 for the three months ended March 31, 2012. Total Company backlog as of March 31, 2012 was \$19,017,998.

To combat high inflation and rising costs in China and to increase overall profitability, we are actively working on expanding our customer base to increase total demand which reduces per unit cost, optimizing our product mix by carrying out research and development (“R&D”) to improve profitability of existing products and launch new high value-add products, and prioritizing higher margin products among existing customers and markets. We will also continue to take appropriate actions to perform business and credit reviews of customers and suppliers and strengthen collection of accounts receivable with the goal to maintain overall healthy sales volume, margins and cash positions.

We believe that high barriers to entry in the Chinese domestic precision cold-rolled steel industry still exist because of the level of technological expertise and the amount of capital required for operation. Although we expect a continuation of volatility in demand in both domestic and international markets, and a difficult operating environment due to a weakening Chinese economy and rising costs which could continue to have adverse impacts on our gross margins in the near future, the medium to long term prospects of our niche remain optimistic. We believe that our unique capabilities and know-how give us a competitive advantage to grow sales and build a globally recognized brand as we continue to carry out R&D and expand to new segments, customers and markets.

The following are some financial highlights for the third fiscal quarter:

· **Revenues:** Our revenues were approximately \$29.5 million for the third quarter, a decrease of 6.3% from last year.

· **Gross Margin:** Gross margin was (3.8)% for the third quarter, as compared to (0.1)% last year.

· **(Loss) from operations before income tax:** Loss from operations before income tax was approximately \$3.3 million for the third quarter, as compared to approximately \$0.9 million last year.

· **Net (loss):** Net loss was approximately \$3.3 million for the third quarter, as compared to approximately \$0.9 million last year.

***Fully diluted (loss) per share:*** Fully diluted loss per share was \$0.07 for the third quarter, as compared to \$0.02 last year.

## **Results of Operations**

The following table sets forth key components of our results of operations for the periods indicated, in USD and as a percentage of revenues.

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**Comparison of Three and Nine Months Ended March 31, 2012 and 2011**

|                                                 | Three Months Ended March 31, |               |              |               | Nine months Ended March 31, |               |               |               |
|-------------------------------------------------|------------------------------|---------------|--------------|---------------|-----------------------------|---------------|---------------|---------------|
|                                                 | 2012                         |               | 2011         |               | 2012                        |               | 2011          |               |
|                                                 | Amount                       | % of Revenues | Amount       | % of Revenues | Amount                      | % of Revenues | Amount        | % of Revenues |
| Revenues                                        | \$29,494,865                 | 100.0         | \$31,489,118 | 100.0         | \$105,324,043               | 100.0         | \$105,154,101 | 100.0         |
| Cost of sales                                   |                              |               |              |               |                             |               |               |               |
| (including depreciation and amortization)       | 30,612,073                   | 103.8         | 31,530,734   | 100.1         | 108,178,198                 | 102.7         | 100,902,769   | 96.0          |
| Gross (loss)/profit                             | (1,117,208 )                 | (3.8 )        | (41,616 )    | (0.1 )        | (2,854,155 )                | (2.7 )        | 4,251,332     | 4.0           |
| Selling and marketing expenses                  | 63,734                       | 0.2           | 93,172       | 0.3           | 172,223                     | 0.2           | 201,554       | 0.2           |
| Administrative expenses                         | 781,221                      | 2.7           | 111,068      | 0.4           | 2,007,777                   | 1.9           | 1,708,188     | 1.6           |
| Allowance for bad and doubtful debts            | 522,118                      | 1.8           | 126          | <0.1          | 522,118                     | 0.5           | 19,823        | <0.1          |
| Depreciation and amortization expense           | 54,173                       | 0.2           | 50,173       | 0.2           | 162,610                     | 0.2           | 143,884       | 0.1           |
| Total operating expenses                        | 1,421,246                    | 4.8           | 254,539      | 0.8           | 2,864,728                   | 2.7           | 2,073,449     | 2.0           |
| (Loss)/income from operations                   | (2,538,454 )                 | (8.6 )        | (296,155 )   | (0.9 )        | (5,718,883 )                | (5.4 )        | 2,177,883     | 2.1           |
| Other revenues                                  | 20,434                       | 0.1           | 627          | <0.1          | 89,505                      | 0.1           | 3,239         | <0.1          |
| Interest and finance costs                      | (794,895 )                   | (2.7 )        | (591,118 )   | (1.9 )        | (2,273,473 )                | (2.2 )        | (1,908,969 )  | (1.8 )        |
| Total other (expense)                           | (774,461 )                   | (2.6 )        | (590,491 )   | (1.9 )        | (2,183,968 )                | (2.1 )        | (1,905,730 )  | (1.8 )        |
| (Loss)/income from operations before income tax | (3,312,915 )                 | (11.2 )       | (886,646 )   | (2.8 )        | (7,902,851 )                | (7.5 )        | 272,153       | 0.3           |
| Income tax expense/(benefit)                    | 108                          | <(0.1 )       | (14,149 )    | <(0.1 )       | 27,189                      | <0.1          | 298,358       | 0.3           |
| Net (loss)                                      | \$(3,313,023 )               | (11.2 )       | \$(872,497 ) | (2.8 )        | \$(7,930,040 )              | (7.5 )        | \$(26,205 )   | <(0.1 )       |
| Basic (loss) per share                          | \$(0.07 )                    |               | \$(0.02 )    |               | \$(0.17 )                   |               | \$(0.00 )     |               |
| Diluted (loss) per share                        | \$(0.07 )                    |               | \$(0.02 )    |               | \$(0.17 )                   |               | \$(0.00 )     |               |

**Sales Revenues.** Sales volume increased by 2,423 tons, or 6.6%, period-on-period, to 38,898 tons, for the period ended March 31, 2012, from 36,475 tons for the period ended March 31, 2011, however, due to decrease in average selling prices, sales revenues decreased by \$1,994,253, or 6.3%, period-on-period, to \$29,494,865 for the period

ended March 31, 2012, from \$31,489,118 for the period ended March 31, 2011.

### *Sales by Product Line*

A break-down of our sales by product line for the three months ended March 31, 2012 and 2011 is as follows:

| Product Category        | Three Months ended March 31, |            |               | 2011                       |            |               | Period-on-Period |
|-------------------------|------------------------------|------------|---------------|----------------------------|------------|---------------|------------------|
|                         | 2012<br>Quantity<br>(tons)   | \$ Amount  | % of<br>Sales | 2011<br>Quantity<br>(tons) | \$ Amount  | % of<br>Sales | Qty.<br>Variance |
| Low-carbon hard-rolled  | 2,245                        | 1,597,893  | 5             | 225                        | 278,168    | 1             | 2,020            |
| Low-carbon cold-rolled  | 32,971                       | 23,828,512 | 81            | 27,827                     | 23,031,005 | 73            | 5,144            |
| High-carbon hot-rolled  | 144                          | 133,371    | <1            | 715                        | 733,907    | 2             | (571 )           |
| High-carbon cold-rolled | 3,464                        | 3,384,305  | 11            | 7,065                      | 6,775,354  | 22            | (3,601 )         |
| Subcontracting income   | 74                           | 10,374     | <1            | 643                        | 96,601     | <1            | (569 )           |
| Sales of scrap metal    | -                            | 540,410    | 2             | -                          | 574,083    | 2             | -                |
| Total                   | 38,898                       | 29,494,865 | 100           | 36,475                     | 31,489,118 | 100           | 2,423            |

There were different trends of demand across various product categories during the three months ended March 31, 2012. High-carbon cold-rolled steel products accounted for 11% of the current sales mix at an average selling price of \$977 per ton for the period ended March 31, 2012, compared to 22% of the sales mix at an average selling price per ton of \$959 for the period ended March 31, 2011. The products in this category are mainly used in the automobile industry. Sales volume decreased period-on-period as a result of the slow-down of the auto sector during the period. Low-carbon cold-rolled steel products accounted for 81% of the current sales mix at an average selling price of \$723 per ton for the three months ended March 31, 2012, compared to 73% of the sales mix at an average selling price per ton of \$828 for the three months ended March 31, 2011. The increase in demand in this category during the period was a result of increased orders of steel used in the production of home appliances. Low-carbon hard-rolled steel products accounted for 5% of the current sales mix at an average selling price of \$712 per ton for the three months ended March 31, 2012, compared to 1% of the sales mix at an average selling price per ton of \$1,236 for the three months ended March 31, 2011, due to an increased tonnage sold in the international market period-on-period as we saw an improvement of purchasing activity in the global space at the current price level and the return of old customers who had been holding off orders in the prior periods. Subcontracting income revenues accounted for \$10,374, or less than 1% of the sales mix for the three months ended March 31, 2012, as compared to \$96,601, or less than 1%, of the sales mix for the three months ended March 31, 2011.

|                         | Three<br>Months<br>ended<br>March 31, |       |          |      |
|-------------------------|---------------------------------------|-------|----------|------|
|                         | 2012                                  | 2011  | Variance |      |
| Average Selling Prices  | (\$)                                  | (\$)  | (\$)     | (%)  |
| Low-carbon hard-rolled  | 712                                   | 1,236 | (524)    | (42) |
| Low-carbon cold-rolled  | 723                                   | 828   | (105)    | (13) |
| High-carbon hot-rolled  | 926                                   | 1,026 | (100)    | (10) |
| High-carbon cold-rolled | 977                                   | 959   | 18       | 2    |
| Subcontracting income   | 140                                   | 150   | (10)     | (7)  |

The average selling price per ton decreased to \$758 for the three months ended March 31, 2012, compared to \$863 last year, representing a decrease of \$105, or 12.2%, period-on-period. This decrease was mainly due to decreases in the average selling prices of low-carbon products, period-on-period.

#### *Sales Breakdown by Major Customer*

| Customers                                    | 2012       |            | 2011        |            |
|----------------------------------------------|------------|------------|-------------|------------|
|                                              | \$         | % of Sales | \$          | % of Sales |
| Shanghai Bayou Manufacturing Co., Ltd.       | 13,708,730 | 46         | -           | * - *      |
| Changshu Jiacheng Steel Plating Co., Ltd.    | 3,661,289  | 12         | -           | * - *      |
| Jiangsu Sumec Group Corporation              | 3,495,647  | 12         | -           | * - *      |
| Zhejiang Yejin Materials Co., Ltd.           | 2,687,696  | 9          | -           | * - *      |
| Shanghai Shengdejia Metal Products Co., Ltd. | 2,353,098  | 8          | 4,548,200   | 14         |
| Shanghai Changshuo Steel Co., Ltd.           | -          | * -        | * 5,063,932 | 16         |
| Wuxi Xingyu Thin Plate Co., Ltd.             | -          | * -        | * 3,559,802 | 11         |
| Sinolight Materials Corporation              | -          | * -        | * 3,293,373 | 11         |
| Zhejiang Aoguan Thin Plate Co. Ltd.          | -          | * -        | * 2,994,056 | 10         |
|                                              | 25,906,460 | 87         | 19,459,363  | 62         |
| Others                                       | 3,588,405  | 13         | 12,029,755  | 38         |
| Total                                        | 29,494,865 | 100        | 31,489,118  | 100        |

*\* Not major customers for the relevant periods*

Sales revenues generated from our top five major customers as a percentage of total sales increased to 87% for the period ended March 31, 2012, compared to 62% for the period ended March 31, 2011. Four top customers are new major customers for the period ended March 31, 2012. This change in customer mix reflects management's continuous efforts in expanding our customer base and geographical coverage during the course of the quarter.

**Cost of Goods Sold.** Cost of sales decreased by \$918,661, or 2.9%, period-on-period, to \$30,612,073 for the period ended March 31, 2012, from \$31,530,734 for the period ended March 31, 2011. Cost of sales represented 103.8% of sales revenues for the period ended March 31, 2012, compared to 100.1% for the period ended March 31, 2011. Average cost of production per ton decreased to \$787 for the period ended March 31, 2012, compared to an average cost of production per ton of \$864 for the period ended March 31, 2011, representing a decrease of \$77 per ton, or 8.9%, period-on-period.

|                                     | 2012<br>(\$) | 2011<br>(\$) | Variance<br>(\$) | (%)     |
|-------------------------------------|--------------|--------------|------------------|---------|
| Cost of goods sold                  |              |              |                  |         |
| - Raw materials                     | 28,139,271   | 28,587,486   | (448,215 )       | (1.6 )  |
| - Direct labor                      | 132,304      | 136,986      | (4,682 )         | (3.4 )  |
| - Manufacturing overhead            | 2,340,498    | 2,806,262    | (465,764 )       | (16.6 ) |
|                                     | 30,612,073   | 31,530,734   | (918,661 )       | (2.9 )  |
| Cost per unit sold                  |              |              |                  |         |
| Total units sold (tons)             | 38,898       | 36,475       | 2,423            | 6.6     |
| Average cost per unit sold (\$/ton) | 787          | 864          | (77 )            | (8.9 )  |

The decrease in cost of sales is represented by the combined effect of:

a decrease in cost of raw materials per unit sold of \$61, or 7.8%, from \$784 for the period ended March 31, 2011, to \$723 for the period ended March 31, 2012; and

a decrease in manufacturing overhead per unit sold of \$17, or 22.1%, from \$77 for the period ended March 31, 2011, to \$60 for the period ended March 31, 2012.

The cost of raw materials consumed decreased by \$448,215, or 1.6%, period-on-period, to \$28,139,271 for the period ended March 31, 2012, from \$28,587,486 for the period ended March 31, 2011. This decrease was mainly due to a decrease in average raw material cost per unit sold and was offset by an increase in total units sold.

Direct labor costs decreased by \$4,682, or 3.4%, period-on-period, to \$132,304 for the period ended March 31, 2012, from \$136,986 for the period ended March 31, 2011. The decrease was due to a decrease in average direct labor cost per unit sold due to increased economies of scale during the period and was offset by an increase in total units sold.

Manufacturing overhead costs decreased by \$465,764, or 16.6%, period-on-period, to \$2,340,498 for the period ended March 31, 2012, from \$2,806,262 for the period ended March 31, 2011. The decrease was mainly attributable to the combined effect of a decrease in consumables of \$82,717 or 22.9%, period-on-period, to \$279,233 for the period ended March 31, 2012, from \$361,950 for the period ended March 31, 2011, and a decrease in utilities of \$172,064, or 22.4%, period-on-period, to \$594,746 for the period ended March 31, 2012, from \$766,810 for the period ended March 31, 2011.

**Gross Loss.** Gross loss in absolute terms increased by \$1,075,592, or 2,584.6%, period-on-period, to a loss of \$1,117,208 for the period ended March 31, 2012, from a loss of \$41,616 for the period ended March 31, 2011, while gross loss margin increased to 3.8% for the period ended March 31, 2012, from 0.1% for the period ended March 31, 2011. The increase in gross loss was mainly attributable to a 6.3% period-on-period decrease in sales revenues, and was offset by a 2.9% period-on-period decrease in cost of goods sold. The increase in gross loss margin principally resulted from a decrease in average selling price per unit sold period-on-period.

**Selling Expenses.** Selling expenses decreased by \$29,438, or 31.6%, period-on-period, to \$63,734 for the period ended March 31, 2012, compared to the corresponding period in 2011 of \$93,172. The decrease was mainly attributable to decreased sales commissions period-on-period.

**Administrative Expenses.** Administrative expenses increased by \$670,153, or 603.4%, period-on-period, to \$781,221 for the period ended March 31, 2012 compared to \$111,068 for the period ended March 31, 2011. This increase was chiefly associated with an inventories write down in the amount of \$636,405 during the period ended March 31, 2012.

**Provision for Bad Debt.** Provision for bad debt was \$126 based on our policy for allowance for doubtful accounts for the period ended March 31, 2011 and \$522,118 for the period ended March 31, 2012.

**(Loss) from Operations.** Loss from operations before income tax was \$3,312,915 for the period ended March 31, 2012 as compared to \$886,646 for the period ended March 31, 2011, as a result of the factors discussed above.

**Other Income.** Our other income increased by \$19,807, or 3,159.0%, to \$20,434 for the period ended March 31, 2012 from \$627 for the period ended March 31, 2011. The increase in other income was primarily due to gain on disposal of a motor vehicle during the period ended March 31, 2012.

**Interest Expense.** Total interest expense increased \$203,777 or 34.5%, to \$794,895 for the period ended March 31, 2012, from \$591,118 for the period ended March 31, 2011, due to increased interest rates period-on-period.

**Income Tax.** For the period ended March 31, 2011, we recognized an income tax benefit of \$14,149, compared to an expense of \$108 for the period ended March 31, 2012.

**Net Loss.** Net loss increased by \$2,440,526, or 279.7%, period-on-period, to a net loss of \$3,313,023 for the period ended March 31, 2012 from \$872,497 for the period ended March 31, 2011. The increase in net loss is attributable to a combination of the factors discussed above, but principally the negative gross profit margin and higher operating expenses period-on-period.

**Comparison of Nine months Ended March 31, 2012 and 2011**

**Sales Revenues.** Sales volume decreased by 1,871 tons, or 1.5%, period-on-period, to 124,353 tons for the period ended March 31, 2012 from 126,224 tons for the period ended March 31, 2011 while sales revenues increased by \$169,942 or 0.2%, period-on-period, to \$105,324,043 for the period ended March 31, 2012, from \$105,154,101 for the period ended March 31, 2011. The increase in sales revenues is mainly attributable to a small increase in average selling price period-on-period.

***Sales by Product Line***

A break-down of our sales by product line for the nine months ended March 31, 2012 and 2011 is as follows:

| Product Category       | Nine months Ended March 31, 2012 |           |            | 2011               |           |            | Period-on-Period |
|------------------------|----------------------------------|-----------|------------|--------------------|-----------|------------|------------------|
|                        | Quantity<br>(tons)               | \$ Amount | % of Sales | Quantity<br>(tons) | \$ Amount | % of Sales | Qty.<br>Variance |
| Low-carbon hard-rolled | 8,998                            | 6,605,610 | 6.3        | 4,684              | 3,805,289 | 3.6        | 4,314            |

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|                         |         |             |      |         |             |      |           |
|-------------------------|---------|-------------|------|---------|-------------|------|-----------|
| Low-carbon cold-rolled  | 96,702  | 78,339,578  | 74.4 | 81,281  | 71,309,759  | 67.8 | 15,421    |
| High-carbon hot-rolled  | 3,321   | 3,659,608   | 3.5  | 3,929   | 3,694,751   | 3.5  | (608 )    |
| High-carbon cold-rolled | 13,316  | 13,788,270  | 13.1 | 19,814  | 18,456,360  | 17.6 | (6,498 )  |
| Subcontracting income   | 2,016   | 1,076,389   | 1.0  | 16,516  | 6,339,606   | 6.0  | (14,500 ) |
| Sales of scrap metal    | -       | 1,854,588   | 1.7  | -       | 1,548,336   | 1.5  | -         |
| Total                   | 124,353 | 105,324,043 | 100  | 126,224 | 105,154,101 | 100  | (1,871 )  |

There were different trends of demand across various product categories during the nine months ended March 31, 2012. High-carbon cold-rolled steel products accounted for 13.1% of the current sales mix at an average selling price of \$1,035 per ton for the period ended March 31, 2012, compared to 17.6% of the sales mix at an average selling price per ton of \$931 for the period ended March 31, 2011. The products in this category are mainly used in the automobile industry. Low-carbon cold-rolled steel products accounted for 74.4% of the current sales mix at an average selling price of \$810 per ton for the nine months ended March 31, 2012, compared to 67.8% of the sales mix at an average selling price per ton of \$877 for the nine months ended March 31, 2011. The increase in demand in this category during the period was a result of increased orders of steel used in the production of home appliances due to government subsidies to encourage consumer spending in the prior period. Low-carbon hard-rolled steel products accounted for 6.3% of the current sales mix at an average selling price of \$734 per ton for the nine months ended March 31, 2012, compared to 3.6% of the sales mix at an average selling price per ton of \$812 for the nine months ended March 31, 2011, due to an improvement in demand at the current price level in the international market period-on-period. Subcontracting income revenues accounted for \$6,339,606, or 6.0%, of the sales mix for the nine months ended March 31, 2011, as compared to \$1,076,389, or 1.0%, of the sales mix for the nine months ended March 31, 2012.

|                         | Nine months<br>Ended<br>March 31, |      |          |        |
|-------------------------|-----------------------------------|------|----------|--------|
|                         | 2012                              | 2011 | Variance |        |
| Average Selling Prices  | (\$)                              | (\$) | (\$)     | (%)    |
| Low-carbon hard-rolled  | 734                               | 812  | (78 )    | (9.6 ) |
| Low-carbon cold-rolled  | 810                               | 877  | (67 )    | (7.6 ) |
| High-carbon hot-rolled  | 1,102                             | 940  | 162      | 17.2   |
| High-carbon cold-rolled | 1,035                             | 931  | 104      | 11.2   |
| Subcontracting income   | 534                               | 384  | 150      | 39.1   |

The average selling price per ton increased to \$847 for the nine months ended March 31, 2012, compared to the \$833 in 2011, representing an increase of \$14, or 1.7%, period-on-period. This increase was mainly due to increases in the average selling prices of high-carbon products and was offset by decreases in the average selling prices of low-carbon products, period-on-period.

#### *Sales Breakdown by Major Customer*

|                                                                  | Nine months Ended March 31, |            |             |            |
|------------------------------------------------------------------|-----------------------------|------------|-------------|------------|
|                                                                  | 2012                        |            | 2011        |            |
| Customers                                                        | \$                          | % of Sales | \$          | % of Sales |
| Shanghai Changshuo Steel Co., Ltd.                               | 12,068,785                  | 11         | 16,927,848  | 16         |
| Shanghai Shengdeji Metal Products Co., Ltd.                      | 14,107,630                  | 13         | 23,169,045  | 22         |
| Hangzhou Cogeneration Import & Export Co., Ltd.                  | 11,204,723                  | 11         | -           | * - *      |
| Zhejiang Yongfeng Steel Co., Ltd.                                | 7,957,124                   | 8          | -           | * - *      |
| Changshu Jiacheng Steel Plating Co., Ltd.                        | 8,112,915                   | 8          | -           | * - *      |
| Wui Xingyu Thin Plate Co., Ltd.                                  | -                           | * - *      | 8,572,640   | 8          |
| Shaoxing Wangheng Metal Plate Co., Ltd.                          | -                           | * - *      | 7,492,674   | 7          |
| Zhangjiagang Gangxing Innovative Construction Material Co., Ltd. | -                           | * - *      | 6,398,355   | 6          |
| Others                                                           | 53,451,177                  | 51         | 62,560,562  | 59         |
|                                                                  | 51,872,866                  | 49         | 42,593,539  | 41         |
| Total                                                            | 105,324,043                 | 100        | 105,154,101 | 100        |

*\* Not major customers for the relevant periods*

Sales revenues generated from our top five major customers as a percentage of total sales decreased to 51% for the period ended March 31, 2012, compared to 59% for the period ended March 31, 2011. Three top customers are new major customers for the period ended March 31, 2012. The change in customer mix reflects management's continuous efforts in expanding our customer base and geographical coverage during the course of the quarter.

**Cost of Goods Sold.** Cost of sales increased by \$7,275,429, or 7.2%, period-on-period, to \$108,178,198 for the period ended March 31, 2012, from \$100,902,769 for the period ended March 31, 2011. Cost of sales represented 102.7% of sales revenues for the period ended March 31, 2012, compared to 96.0% for the period ended March 31, 2011.

Average cost per ton sold increased to \$870 for the period ended March 31, 2012, compared to \$799 for the period ended March 31, 2011, representing an increase of \$71 per ton, or 8.9%, period-on-period.

|                                     | Nine months Ended March 31, |             |            |       |
|-------------------------------------|-----------------------------|-------------|------------|-------|
|                                     | 2012                        | 2011        | Variance   |       |
|                                     | (\$)                        | (\$)        | (\$)       | (%)   |
| Cost of goods sold                  |                             |             |            |       |
| - Raw materials                     | 98,982,682                  | 91,421,679  | 7,561,003  | 8.3   |
| - Direct labor                      | 428,154                     | 420,870     | 7,284      | 1.7   |
| - Manufacturing overhead            | 8,767,362                   | 9,060,220   | (292,858 ) | (3.2) |
|                                     | 108,178,198                 | 100,902,769 | 7,275,429  | 7.2   |
| Cost per unit sold                  |                             |             |            |       |
| Total units sold (tons)             | 124,353                     | 126,224     | (1,871 )   | (1.5) |
| Average cost per unit sold (\$/ton) | 870                         | 799         | 71         | 8.9   |

The increase in cost of sales is represented by the combined effect of:

an increase in cost of raw materials per unit sold of \$72, or 9.9%, from \$724 for the period ended March 31, 2011, to \$796 for the period ended March 31, 2012; and was offset by

a decrease in factory overhead per unit sold of \$1, or 1.4%, from \$72 for the period ended March 31, 2011, to \$71 for the period ended March 31, 2012.

The cost of raw materials consumed increased by \$7,561,003, or 8.3%, period-on-period, from \$91,421,679 for the period ended March 31, 2011 to \$98,982,682 for the period ended March 31, 2012. This increase was mainly due to an increase in raw material costs and was offset by a decrease in total units sold period-on-period.

Direct labor costs increased by \$7,284, or 1.7%, period-on-period, to \$428,154 for the period ended March 31, 2012, from \$420,870 for the period ended March 31, 2011.

Manufacturing overhead costs decreased by \$292,858, or 3.2%, period-on-period, from \$9,060,220 for the period ended March 31, 2011, to \$8,767,362 for the period ended March 31, 2012. The decrease was mainly attributable to the combined effect of a decrease in utilities of \$145,572, or 5.9%, period-on-period, from \$2,484,358 for the period ended March 31, 2011, to \$2,338,786 for the period ended March 31, 2012, and a decrease in consumables of \$135,384, or 10.2%, period-on-period, from \$1,329,380 for the period ended March 31, 2011, to \$1,193,796 for the period ended March 31, 2012.

**Gross Profit.** Gross profit in absolute terms decreased by \$7,105,487, or 167.1%, period-on-period, to a loss of \$2,854,155 for the period ended March 31, 2012, from a profit of \$4,251,332 for the period ended March 31, 2011, while gross profit margin decreased to (2.7%) for the period ended March 31, 2012, from 4.0% for the period ended March 31, 2011. The decrease in gross profit was mainly attributable to a 7.2% period-on-period increase in cost of goods sold, and was offset by a 0.2% period-on-period increase in sales revenues.

**Selling Expenses.** Selling expenses decreased by \$29,331, or 14.6%, period-on-period, to \$172,223 for the period ended March 31, 2012, compared to the corresponding period in 2011 of \$201,554. This reflects our control of selling expenses as revenue increased 0.2% period-on-period.

**Administrative Expenses.** Administrative expenses increased by \$299,589, or 17.5%, period-on-period, to \$2,007,777 for the period ended March 31, 2012, from to \$1,708,188 for the period ended March 31, 2011. This increase was chiefly associated with an inventories write down in the amount of \$636,405 that was partially offset by decreases in traveling expenses and professional fees during the period ended March 31, 2012.

**Provision for Bad Debt.** Provision for bad debt was \$19,823 based on our policy for allowance for doubtful accounts for the period ended March 31, 2011 and \$522,118 for the period ended March 31, 2012.

**(Loss)/Income from Operations.** Loss from operations before income tax increased by \$8,175,004, or 3,003.8%, period-on-period, to a loss of \$7,902,851 for the period ended March 31, 2012, from an income of \$272,153 for the period ended March 31, 2011, as a result of the factors discussed above.

**Other Income.** Other income increased \$86,266, or 2,663.4%, to \$89,505 for the period ended March 31, 2012, from \$3,239 for the period ended March 31, 2011. The increase in other income was primarily due to gain on disposal of a motor vehicle during the period ended March 31, 2012.

**Interest Expense.** Total interest expense increased \$364,504, or 19.1%, to \$2,273,473 for the period ended March 31, 2012, from \$1,908,969 for the period ended March 31, 2011 due to increased interest rate period-on-period.

**Income Tax.** For the period ended March 31, 2012, we recognized an income tax expense of \$27,189, compared to \$298,358 of income tax expense for the period ended March 31, 2011. The decrease in income taxes is a result of a net loss made during the period ended March 31, 2012.

**Net (Loss).** Net loss increased by \$7,903,835 period-on-period, to \$7,930,040 for the period ended March 31, 2012, from \$26,205 for the period ended March 31, 2011. The increase in net loss is attributable to a combination of factors discussed above, principally the negative gross profit margin for the period ended March 31, 2012.

## Liquidity and Capital Resources

### General

Our business is capital intensive and requires substantial expenditures for, among other things, the purchase and maintenance of plant and equipment used in our operations. Our short-term and long-term liquidity needs arise primarily from capital expenditures, working capital requirements and principal and interest payments related to our outstanding indebtedness. We have met these liquidity requirements with cash provided by operations, equity financing, and bank debt. As of March 31, 2012, we had cash and cash equivalents of approximately \$2.2 million.

The following table provides detailed information about our net cash flow for all financial statement periods presented in this report:

### CASH FLOW

|                                                     | Nine months Ended March |                |
|-----------------------------------------------------|-------------------------|----------------|
|                                                     | 31,                     |                |
|                                                     | 2012                    | 2011           |
| Net cash provided by/(used in) operating activities | \$2,656,545             | \$(3,962,037 ) |
| Net cash (used in) investing activities             | (309,635 )              | (9,635,527 )   |
| Net cash (used in) financing activities             | (2,874,740)             | (273,290 )     |
| Net cash flow                                       | (463,145 )              | (12,628,715)   |

***Operating Activities***

Net cash flows used in operating activities for the period ended March 31, 2011 was \$3,962,037, as compared with \$2,656,545 provided by operating activities for the period ended March 31, 2012, for a net increase of \$6,618,582. This increase was mainly due to an increase in cash inflow from advances from customers of \$3,610,094 and a decrease in cash outflow for advances to suppliers of \$23,431,802, and was offset by a decrease in cash inflow from accounts receivable of \$22,206,923 during the period ended March 31, 2012.

For the period ended March 31, 2012, sales revenues generated from the top five major customers as a percentage of total sales decreased to 51%, as compared to 59% for the period ended March 31, 2011. The loss of all or portion of the sales volume from a significant customer would have an adverse effect on our operating cash flows. We note that the continuation or intensification of the worldwide economic crisis may have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations to us, resulting in unrecoverable losses on our accounts receivable. We have been strengthening our collection activities and will continue to closely monitor any changes in collection experience and the credit ratings of our customers. From time to time we will review credit periods offered, along with our collection experience and the other relevant factors, to evaluate the adequacy of our allowance for doubtful accounts, and to make changes to the allowance, if necessary. Delays or non-payment of accounts receivable would have an adverse effect on our operating cash flows.

### ***Investing Activities***

Our main uses of cash for investing activities during the period ended March 31, 2012 were for the purchase of property, plant and equipment related to the addition of annealing furnaces and slitting equipment at our Shanghai Blessford facilities. We believe these capital investments increase our capacity, expand product line and improve product qualities, thereby creating opportunities to grow sales, enter new markets and further strengthen our leading position in the niche cold rolling segment that we operate in.

Net cash flows used in investing activities for the period ended March 31, 2012 were \$309,635 as compared with \$9,635,527 for the period ended March 31, 2011. Cash outflow for investing activity decreased during the period ended March 31, 2012 as the majority payment for the above-mentioned construction project had been made in prior periods.

We forecast capital expenditures to remain relatively low in the coming years as the Company does not have material expansion plans as at March 31, 2012.

### ***Financing Activities***

Net cash flows used in financing activities for the period ended March 31, 2012 was \$2,874,740 as compared with \$273,290 for the period ended March 31, 2011. During the period ended March 31, 2012, the Company made repayment of long-term loan in the amount of \$2,874,740.

On December 30, 2008, we filed a universal shelf registration statement with the SEC which has been declared effective. The shelf registration permits us to issue securities valued at up to an aggregate of \$40 million and gives us the flexibility to issue registered securities, from time to time, in one or more separate offerings or other transactions with the size, price and terms to be determined at the time of issuance. Although we do not have any commitments or current intentions to sell securities under the registration statement, we believe that it is prudent to have a shelf registration statement in place to ensure financing flexibility should the need arise.

Our working capital requirements and the cash flow provided by future operating activities will vary from quarter to quarter, and are dependent on factors such as volume of business and payment terms with our customers. As such, we may need to rely on access to the financial markets to provide us with significant discretionary funding capacity. However, the current uncertainty arising out of domestic and global economic conditions, including the recent disruption in credit markets, poses a risk to the economies in which we operate and may adversely impact our

potential sources of capital financing. The general unavailability of credit could make capital financing more expensive for us or impossible altogether. Even if we are able to obtain credit, the incurrence of indebtedness could result in increased debt service obligations. Our inability to renew our short-term loans that are due in July 2012, and the unavailability of additional debt financing as a result of economic pressures on the credit and equity markets could have a material adverse effect on our business operations.

### ***Current Assets***

Current assets increased by \$6,014,839, or 5.0%, period-on-period, to \$127,425,132 as of March 31, 2012, from \$121,410,293 as of June 30, 2011, principally as a result of an increase in accounts receivable of \$3,914,585, or 9.5%, period-on-period, and an increase in inventories of \$3,440,837, or 13.7%, period-on-period.

Accounts receivable, representing 36% of total current assets as of March 31, 2012, is a significant asset of the Company. We offer credit to our customers in the normal course of our business and accounts receivable is stated net of allowance for doubtful accounts. Credit periods vary substantially across industries, segments, types and size of companies in China where we principally operate our business. Because of the niche products that we process, our customers are usually also niche players in their own respective segment, who then sell their products to the end product manufacturers. The business cycle is relatively long, as well as the credit periods. The Company offers credit to its customers for periods of 60 days, 90 days, 120 days and 180 days. We generally offer the longer credit terms to longstanding recurring customers with good payment histories and sizable operations. From time to time we review these credit periods, along with our collection experience and the other factors discussed above, to evaluate the adequacy of our allowance for doubtful accounts, and to make changes to the allowance, if necessary. If our actual collection experience or other conditions change, revisions to our allowances may be required, including a further provision which could adversely affect our operating income, or write back of provision when estimated uncollectible accounts are actually collected.

Our management determines the collectability of outstanding accounts by maintaining quarterly communication with such customers and obtaining confirmation of their intent to fulfill their obligations to the Company. In making this determination, our management also considers past collection experience, our relationship with customers and the impact of current economic conditions on our industry and market. We note that the continuation or intensification of the current global economic crisis may have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations. To reserve for potentially uncollectible accounts receivable, for the period ended March 31, 2012, our management has made a 50% provision for all accounts receivable that are over 180 days past due and full provision for all accounts receivable over one year past due. From time to time, we will review these credit periods, along with our collection experience and the other factors discussed above, to evaluate the adequacy of our allowance for doubtful accounts, and to make changes to the allowance, if necessary. If our actual collection experience or other conditions change, revisions to our allowances may be required, including a further provision which could adversely affect our operating income, or write back of provision when estimated uncollectible accounts are actually collected.

The following table reflects the aging of our accounts receivable March 31, 2012 and June 30, 2011:

**March 31, 2012**

| US\$  | Total      | Current   | 1 to 30 days | 31 to 90 days | 91 to 180 days | 181 to 360 days | over 1 year |
|-------|------------|-----------|--------------|---------------|----------------|-----------------|-------------|
| TOTAL | 46,342,244 | 8,291,430 | 413,239      | 6,897,524     | 28,631,463     | 976,527         | 1,132,061   |
| %     | 100        | 18        | 1            | 15            | 63             | 3               | 1           |

**June 30, 2011**

| US\$  | Total      | Current    | 1 to 30 days | 31 to 90 days | 91 to 180 days | 181 to 360 days | over 1 year |
|-------|------------|------------|--------------|---------------|----------------|-----------------|-------------|
| TOTAL | 42,399,379 | 20,132,384 | 1,570,163    | 6,829,813     | 12,801,682     | 94,799          | 970,538     |
| %     | 100        | 48         | 4            | 16            | 30             | <1              | 2           |

Management continues to take appropriate actions to perform business and credit reviews of any prospective customers (whether new or returning) to protect the Company from any who might pose a high credit risk to our business based on their commercial credit reports, our past collection history with them, and our perception of the risk posed by their geographic location. For example, since the year ended June 30, 2010, we have halted all our direct sales transactions with customers in the Philippines as we consider the associated credit risk being relatively high. Based on publicly available reports, such as that issued by A.M. Best, there is a high risk that financial volatility may erupt in that country due to inadequate reporting standards, a weak banking system or asset markets and/or poor regulatory structure. We expect to resume such exports when conditions improve. Management is also of the opinion that we do not currently have any high risk receivables on our accounts.

***Current Liabilities***

Current liabilities increased by \$7,398,493, or 14.6%, period-on-period, to \$58,232,388 as of March 31, 2012, from \$50,833,895 as of June 30, 2011. The increase was mainly attributable to an increase in accounts payable and accrued expenses of \$2,943,948, or 52.6%, period-on-period, and an increase in advances from customers of \$4,148,595, or 182.3%, period-on-period.

As of March 31, 2012, we had \$27,502,237 in short term-loans. These short-term loans are due on July 31, 2012. We expect to refinance such debt at its maturity, but we cannot assure you that we will be able to do so on terms favorable to the Company or at all.

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**Capital Expenditures**

During the nine month period ended March 31, 2012, we invested \$365,568 in purchases of property, plant and equipment, and construction projects in relation to annealing furnaces and slitting equipment.

**Loan Facilities**

The following table illustrates our credit facilities as of March 31, 2012, providing the name of the lender, the amount of the facility, the date of issuance and the maturity date:

All amounts in U.S. dollars

| Lender                                                         | Date of Loan  | Maturity Date | Duration | Interest Rate               | Principal Amount                  |
|----------------------------------------------------------------|---------------|---------------|----------|-----------------------------|-----------------------------------|
| Raiffeisen Zentralbank Österreich AG (“RZB”)                   | June 29, 2011 | July 31, 2012 | 1 year   | 1.15 times of the PBOC rate | \$ 7,966,023<br>RMB(50,154,084 )  |
| Raiffeisen Zentralbank Österreich AG                           | June 29, 2011 | July 31, 2012 | 1 year   | 1.15 times of the PBOC rate | \$ 19,536,214<br>RMB(123,000,000) |
| DEG – Deutsche Investitions – und Entwicklungsgesellschaft mbH | June 29, 2010 | June 15, 2016 | 6 years  | 6 month USD LIBOR + 4.5%    | \$ 16,200,000<br>RMB(101,995,200) |
| Total                                                          |               |               |          |                             | \$ 43,702,237                     |

As of March 31, 2012, we had \$27,502,237 in short-term loans secured by inventories, land use rights, buildings, plant and machinery, and \$16,200,000 in long-term loan secured by plant and machinery and guaranteed by the Company, as illustrated in the above table.

The short-term loans are due and renewable on July 31, 2012. Our inability to renew, and the unavailability of additional debt financing as a result of economic pressures on the credit and equity markets could have a material adverse effect on our business operations.

We believe that our currently available working capital and the credit facilities referred to above should be adequate to sustain our operations at our current levels and support our contractual commitments through the next twelve months. However, our working capital requirements and the cash flow provided by future operating activities vary from

quarter to quarter, depending on the volume of business during the period and payment terms with our customers. As we expect a continuation of volatility in demand and steel prices in both domestic and international markets in the foreseeable future, our operating cash flows might be significantly negatively impacted by reduced sales and margins. Management has strengthened its sales and marketing activities, and continues to be in talks with potential customers whose past orders we had been unable to fill due to full capacity, which if successful, could result in additional sales and mitigate the impact of the weakened demand and margins on our operating cash flow. As of March 31, 2012, the Company also had \$4,194,134 in debt obligation for interest relating to its short-term and long-term loans. As such, we may need to rely on access to the financial markets to provide us with significant discretionary funding capacity. However, continued uncertainty arising out of domestic and global economic conditions, including the continuing disruption in credit markets, poses a risk to the economies in which we operate and may adversely impact our potential sources of capital financing. The general unavailability of credit could make capital financing more expensive for us or impossible altogether. Even if we are able to obtain credit, the incurrence of indebtedness could result in increased debt service obligations and could result in operating and financing covenants that could restrict our present and future operations.

### ***Obligations under Material Contracts***

Below is a table setting forth our material contractual obligations as of March 31, 2012; debt obligations include principal repayments and interest payments:

| Contractual obligations:                      | Payments Due By Year |                  |                       |                       |                              |
|-----------------------------------------------|----------------------|------------------|-----------------------|-----------------------|------------------------------|
|                                               | Total                | Fiscal Year 2012 | Fiscal Year 2013-2014 | Fiscal Year 2015-2016 | Fiscal Years 2017 and Beyond |
| Short-Term Debt Obligations                   | \$29,577,006         | \$1,037,384      | \$28,539,621          | \$-                   | \$ -                         |
| Current Portion of Long-Term Debt Obligations | \$4,400,649          | \$2,223,873      | \$2,176,776           | \$-                   | \$ -                         |
| Long-Term Debt Obligations                    | \$13,918,716         | \$-              | \$6,247,746           | \$7,670,970           | \$ -                         |
|                                               | \$47,896,371         | \$3,261,257      | \$36,964,143          | \$7,670,970           | \$ -                         |

## Recent Accounting Pronouncements

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" ("ASU 2011-04"). This update amends ASC Topic 820, "Fair Value Measurement and Disclosure." ASU 2011-04 clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. ASU 2011-04 is effective for annual and interim reporting periods beginning on or after December 15, 2011, which means that it became effective for our fiscal quarter beginning January 1, 2012. The new guidance is to be adopted prospectively and early adoption is not permitted. The adoption of ASU 2011-04 did not have a significant impact on our financial position, results of operations or cash flows.

On June 16, 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income" ("ASU 2011-05"). This update amends ASC Topic 220, "Comprehensive Income" to provide that total comprehensive income will be reported in one continuous statement or two separate but consecutive statements of financial performance. Presentation of total comprehensive income in the statement of stockholders' equity or the footnotes will no longer be allowed. The calculation of net income and basic and diluted net income per share will not be affected. ASU 2011-005 is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2011, which means that it will be effective for our fiscal year beginning July 1, 2012. Retrospective adoption is required and early adoption is permitted. We do not believe that adoption of ASU 2011-05 will have a significant impact on our financial position, results of operations or cash flows.

In September 2011, the FASB issued ASU 2011-08, "Intangibles – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment" ("ASU 2011-08"). ASU No. 2011-08 amends existing guidance by permitting an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. ASU 2011-08 will be effective for interim and annual periods beginning on or after December 15, 2011 with early adoption permitted. We adopted ASU 2011-08 in the current quarter and this did not have a material impact on our financial statements.

## Seasonality

Our operating results and operating cash flows historically have been subject to seasonal variations. Our revenues are usually higher in the second half of the year than in the first half of the year and the third quarter is usually the slowest quarter because fewer projects are undertaken during and around the Chinese New Year holidays.

**Off-Balance Sheet Arrangements**

For the period ended March 31, 2012, we did not have any off-balance sheet arrangements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Not Applicable.

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#### **ITEM 4. CONTROLS AND PROCEDURES.**

##### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) that are designed to ensure that information that would be required to be disclosed in Exchange Act reports is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including to our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As required by Rule 13a-15 under the Exchange Act, our management, including our Chief Executive Officer, Mr. Hai Sheng Chen, and Chief Financial Officer, Ms. Leada Tak Tai Li, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2012. Based upon, and as of the date of this evaluation, Mr. Chen and Ms. Li, determined that because of the material weaknesses described below, as of March 31, 2012, our disclosure controls and procedures were not effective.

During its review of our consolidated financial statements for the fiscal quarter ended March 31, 2012, our management concluded that our accounting staff lacked sufficient accounting skills and experience necessary to fulfill our public reporting obligations according to U.S. GAAP and the SEC's rules and regulations.

Management is currently seeking for and plans to appoint qualified personnel as soon as possible to remediate this material weakness. Our management does not believe that this material weakness had a material effect on our financial condition or results of operations or caused our financial statements as of and for the fiscal quarter ended March 31, 2012 to contain a material misstatement.

##### **Changes in Internal Controls over Financial Reporting**

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.

There were no changes in our internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS.

From time to time, we may become involved in various lawsuits and legal proceedings, which arise, in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these, or other matters, may arise from time to time that may harm our business.

On March 15, 2012, the Company received notice of a complaint filed by Mr. Haining Zhang and China Venture Partners, Inc. in the U.S. Southern District Court of New York on March 9, 2012, against several defendants, including the Company, as successor to OraLabs Holding Corp. In the complaint Mr. Zhang is alleging, among other things, breach of contract by the Company and certain of our former officers, directors and control persons, in connection with our December 2006 acquisition of Partner Success Holdings Limited. Among other things, Mr. Zhang alleges that the defendants breached an agreement to compensate him for services he allegedly performed in connection with seeking out a merger candidate for the Company. The Company believes that the suit is without merit and intends to vigorously defend its interests in the case. The Company intends to and has been granted Court permission to file a motion to dismiss the action as against it.

Except with respect to the foregoing proceeding, we are currently not aware of any such legal proceedings or claims that we believe will have a material adverse affect on our business, financial condition or operating results.

ITEM 1A. RISK FACTORS.

Not Applicable.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. (REMOVED AND RESERVED).

ITEM 5. OTHER INFORMATION.

We have no information to disclose that was required to be in a report on Form 8-K during the period covered by this report, but was not reported. There have been no material changes to the procedures by which security holders may recommend nominees to our board of directors.

ITEM 6. EXHIBITS.

The following exhibits are filed as part of this report or incorporated by reference:

| Exhibit | Description |
|---------|-------------|
| No.     |             |

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- 31.1\* Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2\* Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1\* Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2\* Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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## **SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 15, 2012 CHINA PRECISION STEEL, INC.

By: /s/ Hai Sheng Chen  
Hai Sheng Chen, Chief Executive Officer  
(Principal Executive Officer)

By: /s/ Leada Tak Tai Li  
Leada Tak Tai Li, Chief Financial Officer  
(Principal Financial Officer and Principal  
Accounting Officer)